1954

National City Monthly Letter on Business and Economic Conditions

New York, April, 1954

General Business Conditions

THE month of March has brought no clear evidence of business improvement and, although the opinion seems to be spreading that the worst of the de cline is over, this is a matter of faith rather than of statistical demonstration.

Some figures, such as unemployment insurance claims and production statistics, point to a levelling off or only moderate decline. Others, such as retail trade reports, have been disappointing, partly because of certain special factors, including the late date of Easter and the prospect for excise tax reductions. Inventory liquidation is proceeding in orderly fashion, but stocks are still a problem in numerous lines, particularly steel and automobiles. Prices of nonferrous metals firmed and sales increased during March, and similar encouraging reports were received for some textiles. New building construction contracts have continued to exceed those of a year ago, and the general level of prices has remained relatively stable.

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Economic developments during March have been watched with particular interest because of a remark by President Eisenhower, at his February 17 press conference, that a failure of employment to pick up seasonally in that month would be a warning calling for the institution of a number of governmental measures to avoid a deep recession. It is apparent that this remark was taken too literally. The President at his March 27 press conference made clear that all significant developments, not just employment, were being watched and that they did not indicate the need for emergency action at this time.

Inventory Adjustment Continuing

The pattern of inventory adjustment appears on the whole to have been little changed in the first quarter. During January and February manufacturers' inventories were cut back at a seasonally adjusted annual rate of $3 to $4 billion, about the same as in the fourth quarter of 1953. According to the National Association of Purchasing Agents, a major share of its membership had by the end of March succeeded in bringing inventories into line with sales, while others had nearly completed the process.

In the steel industry, on the other hand, the growth in mill stocks of ingots and semi-finished steel called for a cutback in weekly production schedules. Output levelled off after reaching a low point of 67.6 per cent of capacity in the week ended March 21. Steel executives, according to *Iron Age*, remain confident of an early upturn. Steel consumption appears to be outrunning production, and in the latter part of March a number of producers noted a quickening in the pace of new orders.

March automobile output of 524,000 passenger cars and 101,000 trucks was the largest for any month since July. Despite a seasonal rise in new passenger car sales, the industry continues to

build more new cars than it is selling, in anticipation of spring demand.

New contract awards for building and other construction in the first three weeks of March continued to exceed those of a year ago, indicating a record first quarter.

Department store sales, which had held up well in January and February, showed in March sizeable year-to-year declines – as much as 13 per cent in the week ended the 20th. With the excise tax reduction effective April 1, and with the approach of Easter, merchants are expecting better comparisons.

Business and Consumer Spending Plans

The way people feel about the current situation and the plans they make for the future are often better guides to the course of the economy than arrays of business statistics. A joint survey by the Securities and Exchange Commission and the U.S. Department of Commerce, conducted in February and early March, indicates that business men feel confident that their sales in 1954 will, on the whole, approximately equal the record set in 1953. They are backing up this confidence with plans to invest $27.2 billion in new plant and equipment during 1954. This represents a decline of 4 per cent from the 1953 record of $28.3 billion – about the same change as was forecast last November in a private survey.

Such steadfastness of investment plans is heartening. It indicates that business planning for the long run, encouraged by prospective tax revision, is not easily deterred by short-term fluctuations. In addition, these plans show that business men recognize the need for modernization of facilities and introduction of cost-cutting equipment, and are aware that under highly competitive conditions these needs are intensified rather than lessened. The maintenance of a high level of business outlays should be a sustaining force.

A second survey, covering consumer attitudes, financial position, and spending plans – conducted in January and February by the University of Michigan for the Federal Reserve Board – was also encouraging. Consumers still appear basically confident about the general outlook, although less optimistic than a year ago. The proportion which feels this is a good time to make major expenditures is about the same as last year. Plans to buy homes, new cars, and household durable goods have been trimmed from 1953 levels, but still compare favorably with the high levels of 1951 and 1952.

The great majority of consumers expect their incomes to be stable or rising during 1954 compared with 1953, and they expect prices generally to be stable or lower. Liquid asset holdings have increased and are somewhat more widely distributed than in recent years. In general, the survey bears out Senator Flanders' recent remark that "The evidence strongly suggests that it is the will to buy rather than the absence of means which is limiting the amount of consumer expenditures at the present time."

Corporate Earnings in 1953

Annual reports for the year 1953 published during the past month by over 1,000 additional companies confirm the trends indicated by the preliminary summary in our March issue. On a new-high record volume of over-all business activity last year, the financial statements now available from 3,444 corporations give combined net income of approximately $13.7 billion after taxes, compared with $12.6 billion in 1952, an increase of 9 per cent. About two-thirds of the individual companies had increases, against one-third with decreases, and a large majority of the major industries showed increases in their group totals. Despite the generally favorable results, there were numerous areas where earnings were poor or even sizeable losses were incurred.

Some companies last year achieved sharp upturns in both sales and earnings as a result of a rebound from the steel strike or low volume in 1952 prevalent in a number of lines. Among most companies, however, the gains in net income were of relatively modest degree and the result primarily of an expansion in dollar sales rather than any appreciable widening of profit margins. Combined net income of the 2,686 nonfinancial companies in our tabulation represents an average net profit after taxes of 5.6 cents per dollar of sales or revenues, the same as in 1952 and comparing with 6.2 cents in 1951. Among the 65 nonfinancial industry groups in our classification, the margins last year widened in 25, narrowed in 35, and remained unchanged in 5. Such margins last year averaged less than 5.0 cents per sales dollar in 42 industry groups, and over 5.0 cents in 23 groups – most of the latter lines being those with low ratios of sales turnover to capital.

Following is a condensed summary of the changes by main divisions of business.

The substantial growth in corporate sales and earnings last year reflects the country's vast postwar program of building up capital funds and investing in plant and equipment for the ex-

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1952 AND 1953

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1952	1953	Per Cent Change†	Book Net Assets Jan. 1 -a 1952	1953	% Return on Net Assets -a 1952	1953	% Margin on Sales -b 1952	1953
21	Baking	$ 52,769	$ 54,340	+ 3	$ 433,517	$ 452,319	12.2	12.0	3.6	3.5
14	Dairy products	63,388	70,519	+11	608,616	639,297	10.4	11.0	2.1	2.2
16	Meat packing	28,622	56,262	+97	815,983	838,190	3.5	6.7	0.4	0.7
21	Sugar	43,238	21,813	—50	531,137	543,641	8.1	4.0	4.4	2.3
80	Other food products	199,095	227,639	+14	1,999,503	2,090,402	10.0	10.9	3.1	3.3
13	Soft drinks	34,950	36,273	+ 4	291,521	301,220	12.0	12.0	7.7	7.8
27	Brewing	35,617	35,314	— 1	329,372	343,089	10.8	10.3	4.2	3.8
12	Distilling	83,208	79,922	— 4	1,073,024	1,098,081	7.8	7.3	3.6	3.3
23	Tobacco products	114,073	132,055	+16	1,246,217	1,324,011	9.2	10.0	3.4	3.9
36	Cotton goods	48,728	57,842	+19	837,159	850,368	5.8	6.8	2.9	3.6
13	Silk and rayon	44,019	36,654	—17	663,955	666,344	6.6	5.5	6.7	5.4
10	Woolen goods	*D-7,474*	*D-9,497*	———	214,534	205,235	— *3.5*	— *4.6*	— *2.4*	— *3.8*
16	Hosiery, knitted goods	7,526	8,422	+12	124,888	130,489	6.0	6.5	3.0	3.4
9	Carpets, floor coverings	16,716	20,929	+25	271,262	276,749	6.2	7.6	3.4	4.1
41	Other textile products	46,231	62,683	+36	898,477	922,371	5.1	6.8	2.5	3.0
35	Clothing and apparel	15,341	17,378	+13	251,566	256,892	6.1	6.8	2.6	2.7
29	Shoes, leather, etc.	25,986	34,170	+31	325,790	338,801	8.0	10.1	2.6	3.2
27	Tires, rubber products	165,357	185,460	+12	1,237,577	1,335,688	13.4	13.9	3.9	4.2
26	Lumber	81,573	77,983	— 4	713,729	760,791	11.4	10.3	8.0	7.0
16	Furniture, wood products	12,575	13,978	+11	124,121	135,460	10.1	10.3	3.9	3.8
79	Paper and allied products	275,298	297,850	+ 8	2,298,316	2,461,947	12.0	12.1	7.3	7.1
34	Printing and publishing	34,767	33,819	— 3	315,664	326,453	11.0	10.4	4.0	3.1
65	Chemical products	599,830	640,464	+ 7	4,443,872	4,823,352	13.5	13.3	7.7	7.6
19	Drugs and medicines	89,131	88,573	— 1	609,897	646,961	14.6	13.7	8.4	8.1
14	Soap, cosmetics, etc.	62,692	65,676	+ 5	497,095	527,974	12.6	12.4	4.8	4.8
21	Paint and varnish	51,737	63,390	+23	481,762	504,636	10.7	12.6	4.3	4.9
95	Petroleum prod. & refining	2,174,935	2,362,140	+ 9	14,984,025	16,402,291	14.5	14.4	10.5	10.6
32	Cement	57,307	63,275	+11	400,172	431,245	14.3	14.7	11.9	12.3
13	Glass products	94,942	105,877	+12	648,682	708,249	14.6	14.9	7.1	6.8
43	Other stone, clay products	116,804	120,693	+ 3	937,091	1,002,392	12.5	12.0	7.5	7.1
51	Iron and steel	535,174	733,686	+37	6,090,392	6,344,590	8.8	11.6	5.0	5.7
12	Agricultural implements	158,263	127,005	—20	1,450,772	1,571,106	10.9	8.1	5.3	4.2
72	Building, heat., plumb. equip.	112,397	115,721	+ 3	1,028,219	1,099,539	10.9	10.5	4.4	4.0
82	Electrical equip., radio & tv.	418,331	461,555	+10	2,825,587	3,064,422	14.8	15.1	4.6	4.3
49	Hardware and tools	45,069	42,547	— 6	414,960	445,599	10.9	9.5	5.1	4.5
39	Household appliances	60,947	56,676	— 7	487,382	526,661	12.5	10.8	4.5	3.6
176	Machinery	270,023	282,737	+ 5	1,914,168	2,085,456	14.1	13.6	5.0	4.8
28	Office equipment	98,975	95,6[illegible]3	— 3	692,848	744,311	14.3	12.8	6.3	5.5
40	Nonferrous metals	335,983	331,085	— 1	2,921,276	3,054,142	11.5	10.8	7.7	6.9
106	Other metal products	185,436	203,913	+10	1,625,805	1,751,176	11.4	11.6	4.1	4.0
21	Autos and trucks	696,719	708,904	+ 2	3,719,119	3,941,196	18.7	18.0	5.5	4.4
65	Automobile parts	158,889	173,030	+ 9	1,208,454	1,303,921	13.1	13.3	4.0	3.8
24	Railway equipment	75,789	81,189	+ 7	864,542	905,458	8.8	9.0	3.8	3.3
37	Aircraft and parts	127,167	167,981	+32	712,084	799,539	17.9	21.0	2.4	2.4
8	Shipbuilding	13,937	19,313	+39	120,905	128,108	11.5	15.1	2.9	3.4
71	Misc. manufacturing	106,651	117,772	+10	1,028,764	1,107,461	10.4	10.6	5.4	5.2
1,781	Total manufacturing	8,068,731	8,780,643	+ 9	65,713,801	70,217,573	12.3	12.5	5.4	5.3
24	Coal mining -c	49,017	27,852	—43	747,595	769,739	6.6	3.6	4.1	2.4
26	Metal mining -c	58,085	53,489	— 8	558,883	584,180	10.4	9.2	10.5	8.6
11	Other mining, quarrying -c	41,516	43,436	+ 5	171,527	178,076	24.2	24.4	23.7	22.2
61	Total mining, quarrying	148,618	124,777	—16	1,478,005	1,531,995	10.1	8.1	7.8	6.3
28	Chain stores—food	57,784	74,505	+29	543,293	586,822	10.6	12.7	1.0	1.1
53	Chain stores—variety, etc.	121,310	121,742	+....	1,269,655	1,307,948	9.6	9.3	3.3	3.3
52	Department and specialty	138,966	144,300	+ 4	1,521,587	1,564,810	9.1	9.2	2.5	2.5
6	Mail order	163,858	163,054	—....	1,380,529	1,486,429	11.9	11.0	3.8	3.8
54	Wholesale and miscellaneous	68,204	66,278	— 3	742,697	793,839	9.2	8.3	2.1	1.8
193	Total trade	550,122	569,879	+ 4	5,457,761	5,739,348	10.1	9.9	2.4	2.4
131	Class 1 railroads -d	838,229	870,822	+ 4	14,867,836	15,376,024	5.6	5.7	7.8	8.2
35	Traction and bus	23,275	25,478	+ 9	513,095	504,973	4.5	5.0	3.1	3.7
11	Shipping	33,692	31,688	— 6	320,127	341,223	10.5	9.3	7.8	6.6
15	Air transport	57,844	63,573	+10	372,655	452,936	15.5	14.0	5.3	5.2
41	Misc. transportation	23,622	25,775	+ 9	254,525	257,790	9.3	10.0	6.4	6.6
233	Total transportation	976,662	1,017,336	+ 4	16,328,238	16,932,946	6.0	6.0	7.3	7.6
242	Electric power, gas, etc. -d	1,078,103	1,200,114	+11	11,545,288	12,623,869	9.3	9.5	13.3	13.4
66	Telephone and telegraph -d	450,934	547,062	+21	5,360,263	6,289,360	8.4	8.7	9.9	11.0
308	Total public utilities	1,529,037	1,747,176	+14	16,905,551	18,913,229	9.0	9.2	12.1	12.5
16	Amusements	34,424	33,839	— 2	442,951	449,675	7.8	7.5	4.2	3.9
41	Restaurant and hotel	14,951	17,245	+15	171,535	179,485	8.7	9.6	3.2	4.4
32	Other business services	51,198	52,945	+ 3	336,404	362,254	15.2	14.6	5.9	6.2
21	Construction	26,296	28,099	+ 7	192,728	212,079	13.6	13.2	3.9	2.7
110	Total amusements, services, etc.	126,869	132,128	+ 4	1,143,618	1,203,493	11.1	11.0	4.5	4.3
330	Commercial banks	598,119	662,491	+11	6,710,600	7,075,450	8.9	9.4	—	—
68	Fire and casualty insurance	167,449	177,708	+ 6	2,299,258	2,524,696	7.3	7.0	—	—
190	Investment trusts -e	274,896	305,219	+11	4,551,369	5,296,604	6.0	5.8	—	—
72	Sales finance	147,062	172.505	+17	938,987	1,054,631	15.7	16.4	—	—
98	Real estate	23,006	18,404	—20	183,830	192,826	12.5	9.5	—	—
758	Total finance	1,210,532	1,336,327	+10	14,684,044	16,144,207	8.2	8.3	—	—
3,444	Grand total	$12,610,571	$13,708,266	+ 9	$121,711,018	$130,682,791	10.4	10.5	5.6	5.6

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent over nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. † Increases or decreases of over 100% not computed. D—Deficit.

Net Income of Leading Corporations for the Years 1952 and 1953

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income After Taxes 1952	Net Income After Taxes 1953	Per Cent Change	% Margin on Sales 1952	% Margin on Sales 1953
1,781	Manufacturing	$ 8,069	$ 8,781	+ 9	5.4	5.3
61	Mining	149	125	—16	7.8	6.8
193	Trade (ret. & whol.)	550	570	+ 4	2.4	2.4
238	Transportation	977	1,017	+ 4	7.3	7.6
308	Public utilities	1,529	1,747	+14	12.1	12.5
110	Amusements, services	127	132	+ 4	4.5	4.3
758	Banks and finance	1,211	1,336	+10	—	—
3,444	Total	$12,611	$13,708	+ 9	5.6	5.6

pansion and modernization of facilities. This broad improvement program since the end of World War II is still continuing at a high level of expenditures, with current estimates indicating only a slight easing for the full year 1954. Benefits of such new capital investment are now being realized not only throughout the manufacturing industries but in transportation, electric power, gas, and telephones, as well as the trade and service industries.

Total net assets or net worth of the reporting companies approximated $130.7 billion at the beginning of 1953, upon which the year's net income represents an average return of 10.5 per cent. This compares with net assets of $121.7 billion at the beginning of 1952 and a return of 10.4 per cent.

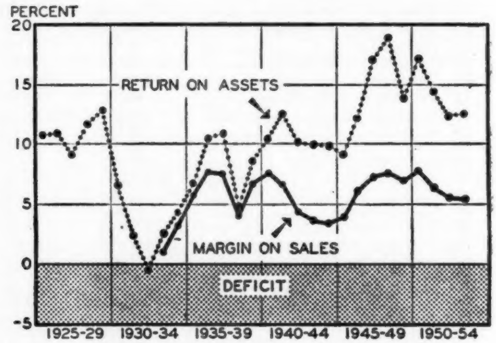
Our detailed summary on the preceding page shows by major industry groups the average rates of return as well as profit margins, both of which measures of earnings are widely used and should be considered together. Because of the wide variations among different industries and individual companies in the ratios of capital turnover and other operating conditions, a wide profit margin does not necessarily mean a high rate of return on capital. Nor does a narrow profit margin necessarily mean a low return.

A profit margin expressed in terms of the sales dollar is perhaps the simplest measure and the most easily understood by the general public. During periods of substantial price changes, earnings and sales both tend to reflect the currently prevailing price levels, whereas book net assets or net worth tends to lag far behind current replacement costs. Rate of return, however, is more useful for comparing earnings in widely diverse fields, and is the only common denominator to include the financial lines, where profit margins do not have the usual significance.

Manufacturers' Sales and Earnings

In the manufacturing industries, statements from 1,781 companies give a combined net income after taxes of approximately $8.8 billion, compared with $8.1 billion in 1952, an increase of 9 per cent. Tax details now available for most of the larger organizations show that, taken as a whole, there was an increase of 11 per cent in pre-tax earnings, of which federal income and excess profits taxes absorbed 54 per cent in 1953, against 53 per cent in 1952.

Since the combined net income increased about the same as sales and net assets, the net profit margin and rate of return stand practically unchanged from the levels of 1952. The long-term trend of these percentages, as computed in our tabulations of prior years, is shown in the chart.



Average Annual Net Profit Margins on Sales and Rates of Return on Net Assets of Leading Manufacturing Corporations

In contrast with the stability shown last year by the manufacturing industry totals, considerable fluctuations are found in the various major branches. These reflect recovery from the steel strike and from slow spots in 1952, already noted, as well as a great variety of special factors. Two additional influences of widespread application were the increasing pressures of competition and of rising costs — both of which tend to hold down profit margins and may well become more pronounced this year.

Taxation for Prosperity

Questions of tax legislation became objects of lively controversy in March as Congress debated and passed a bill to reduce excise taxes selectively and gave consideration to the monumental revision of the Internal Revenue Code. Although the $3 billion cut in personal income taxes and the expiration of the corporate excess profits tax took effect no longer ago than January 1, and the objective of a balanced budget is still some distance away, the natural tendency of Congress in an election year is to give away too much. This tendency was sharpened by the business recession which has led some people to advocate giving retail trade an inflationary shot in

the arm by excusing millions of individuals from the income tax rolls.

The respected Senator George of Georgia, former chairman of the Senate Finance Committee, caught the headlines when he suggested raising the personal income tax exemption from $600 to $800 this year and to $1,000 in 1955, increasing deficit expectations $4½ billion and $8 billion respectively. The excise tax bill, designed primarily to extend rates which otherwise would have declined on April 1, as finally enacted gave many more reductions than had been contemplated originally. Nevertheless, the President signed it as battle lines formed in the Senate on the bill to revise the Internal Revenue Code.

The bill to revise the Revenue Code was passed by the House on March 18 after a move to raise the personal exemption by $100 and to strip out a provision relieving double taxation of dividends was voted down by a narrow margin. The Administration held its line in favor of keeping a broad base of taxation, at the same time giving up moderate amounts of revenue in order to relieve the worst inequities and deterrents to incentive in the present law.

These changes fit the President's prescription, given in his State of the Union message:

> We should now remove the more glaring tax inequities, particularly on small taxpayers; reduce restraints on the growth of small business, and make other changes that will encourage initiative, enterprise and production.

A New Tax Code

The Internal Revenue Code revision, embraced in a bill running to 875 pages, if enacted would be an historic achievement for the 83rd Congress. The internal revenue laws now in force are the result of patchwork changes over generations. Although Treasury and Congressional experts have been gathering ideas and taking note of specific inequities and obscurities for twenty years, it was President Eisenhower's decision a year ago that set the machinery of tax-writing in motion. Chairman Daniel A. Reed of the House Ways and Means Committee in reporting the bill said that his experts had worked 300,000 man-hours on the project and his committee "almost to the point of exhaustion". Obsolete material has been deleted, and provisions have been arranged more logically and understandably.

Beyond this, the bill includes some 3,000 substantive changes in the code designed to remove inequities, to end harassment of the taxpayer, and to reduce the barriers to future expansion of production and employment. These changes would give up an estimated $1.4 billion revenues during the fiscal year ending June 30, 1955. On the other hand, the bill would retain $1.2 billion in the revenues by deferring for another year, until April 1, 1955, a scheduled reduction in the standard income tax rate on corporations from 52 to 47 per cent. In this sense business is footing the bill for the benefits which run not only to itself and to corporate shareholders but to large bodies of individuals laboring under special disadvantages. Indeed, everyone may benefit, and also the federal revenues, if the bill is enacted and succeeds in stimulating risk-taking enterprise.

The Program As a Whole

So many darts have been thrown at the proposal in the Tax Revision bill to ease double taxation of corporate dividends that the impression has been spread that this is the main feature of the Administration's tax program. To gain perspective it is necessary to look at the program as a whole which, as the table shows, affords a release of around $7 billion revenues or just about the amount that government outlays are being reduced this year:

1954 Tax Program

(Figures in Billions of Dollars)

	Corporations	Individuals
Jan. 1 personal income tax reduction[1]		—3.0
Dec. 31 expiration of EPT[2]	—2.0	
April 1 excise tax reduction		—1.0
Tax Revision Bill		
Dividend credit[3]		—0.2
Other benefits to individuals[4]		—0.5
Corp. depreciation allowance[5]	—0.3	
Other benefits to corporations[6]	—0.3	
Totals	—2.6	—4.7

[1] Expiration of increases under Revenue Act of 1951.

[2] Expiration after 6 mos. extension from original June 30, 1953 expiration date. The estimate of revenue loss is subject to a wide range of error.

[3] Revenue loss $240 million in fiscal 1955; $642 million in fiscal 1956; and $814 million when fully operative.

[4] Improvements in tax treatment for working children, child care expenses, doctors' bills, pensioners, farmers, etc.

[5] Allowance of more rapid depreciation in early years will increase tax revenues in later years.

[6] One-year extension of period in which business can offset losses against profits for tax purposes, reducing the tax load on certain types of business income earned abroad, etc.

It will be observed that nearly two-thirds of the benefits out of the whole program go to individuals. The "other benefits to individuals" include better tax treatment for working children, child care expenses, doctors' bills, pensioners, farmers, etc. Apart from the expiration of the excess profits tax, the main benefit to corporations is permission to shift ahead deductions for depreciation and depletion, a change that should yield increased revenues in years to come. On the other hand, the partial relief from double taxation of corporate dividends would scale upwards over three years for a calculated ultimate revenue loss of $814 million a year.

The Dividend Proposal

It is this dividend proposal — costing $240 million revenues in fiscal 1955 — that the minority party in the House would have discarded in favor of an increase in personal income tax exemptions from $600 to $700 at the cost of a revenue loss of $2.3 billion. The calculated deficit by this substitution would thus be enlarged by roughly $2 billion.

The relief from double taxation of dividends would work briefly as follows: In 1956 an individual would exclude from his taxable income dividend income up to $100, calculate his tax in the usual way, and then subtract from his tax bill 10 per cent of the amount of dividends included in his taxable income. The plan would become effective in a graduated way beginning August 1, 1954 and would be fully effective in the calendar year 1956.

The Ways and Means Committee report points out that this formula affords greater relief for the low-income investor than for those at higher income levels:

> The method of relief from double taxation selected by your committee is a modification of the dividends received credit adopted in Canada in 1949. However, the present Canadian credit is 20 percent instead of the 10 percent provided in this bill. Moreover, limiting the credit to the amount of taxable income, when it is less than the amount of dividends, is a restriction not imposed under the Canadian system. On the other hand, the dividend exclusion provided by your committee's bill is more liberal than the Canadian method for persons receiving small amounts of dividend income.

Opposing Views

A minority report signed by nine members of the committee strenuously opposed this feature (as well as others) in the Tax Revision bill, stating: "It is nothing but an insult to the intelligence of the average person to claim that he is being benefited by it." President George Meany of the AFL, disregarding the rest of the tax program and forgetting the need of the wage-earner for tools, blasted the provisions in the bill for higher tax depreciation allowance for business and dividend tax relief as "an indefensible bounty from the public treasury" to wealthy corporations and individuals who would thus be able to "escape paying their just share of the burden of taxation."

Former President Truman said this was the first time he had "ever heard" of a system that taxed investment income at a lower rate than earned income. As a matter of fact, U.S. income tax laws from 1913 up to 1936 had always exempted dividends from the normal income tax. The United Kingdom gives relief from double taxation to the extent of the 45 per cent "standard" tax; Canada gives relief of 20 per cent as contrasted to the 10 per cent proposed here.

Congressman Eberharter of Pennsylvania called the Tax Revision bill:

> an attempt to make the man who earns his daily bread from the sweat of his brow to pay more and more of the $50 billion cost of the cold war with Russia, more and more of our $5 billion in foreign aid spending, more and more of the $2 billion cost of our atomic-energy program, while at the same time letting the investor, the corporation president, and the large stockholder pay less and less.

Congressman Eberharter to the contrary, the only real tax increases provided in the bill are levied against the vilified corporation. The Congressman goes on to credit Secretary of the Treasury Humphrey with authorship of the dividend provision and with the iniquitous intention of ultimately eliminating taxation on dividends.

Double taxation of dividends is an old problem, a subject of study and recommendations by accountants and students of public finance for decades. President Franklin D. Roosevelt, no particular friend of the corporate shareholder, in 1936 urged Congress to solve the problem by entirely eliminating the corporate income tax on distributed profits. "As the law now stands," Mr. Roosevelt said, "our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave earnings undistributed escape current surtaxes altogether."

Mr. Roosevelt could have had no conception at the time of how much higher taxes on corporations and on dividends would become before Congress would get around to even a partial measure of relief. The rate of tax on corporate net income (whether or not distributed) was then 13¾ per cent; today it is 52 per cent. The top personal surtax applicable to dividends at that time was 59 per cent and applied to income above $5,000,000; today the top rate is 91 per cent and falls on income beyond $200,000. The top combined rate of taxation on corporate income distributed to shareholders was then 65 per cent; today it goes as high as 95½ per cent. The relief plan approved by the House would shave this top rate to 90.9 per cent. This is no "bounty" but a mild recognition that over-reaching greed on the part of the revenue collector is bad medicine for a free enterprise economy relying on private capital investment for progress.

Penalty on Risk Investment

It is possible to argue that there is no double taxation of dividends on the hypothesis that the corporate income tax is passed along to the con-

sumer as a concealed sales tax. But the opponents of the partial relief revision do not take this view — one which would logically lead them to press for reduction in corporate income tax to relieve the consumer. They seem to take it for granted that extreme taxation of distributed corporate income is a good thing. Yet at no point do they show that they are aware of either the rates of tax they are in effect advocating, or the constrictive effects of such rates on the supply of risk capital.

To set the record straight on taxation of earned versus dividend income, Congressman Byrnes of Wisconsin, himself not a shareholder, set out a table in the Congressional Record for March 17 which compares, for illustrative income levels, the tax on corporate earnings distributed to shareholders and the tax on nondividend income. This table is reproduced below with the addition of a column showing the effect of the proposal in narrowing the gap.

Combined corporate and individual tax burden on $100 of corporate earnings compared with tax on nondividend income

Assuming all corporate earnings after tax are distributed
(Married person filing joint return)

Individuals's taxable income	Tax on additional $100 of nondividend income	Tax on additional $100 of earnings on corporate shares: Present	Proposed
$ 3,000	$20	$61.60	$56.80
4,000	22	62.56	57.76
8,000	26	64.48	59.68
15,000	30	66.40	61.60
20,000	38	70.24	65.44
25,000	43	72.64	67.84
50,000	59	80.32	75.52
100,000	75	88.00	83.20
300,000	90	95.20	90.40
500,000	91	95.68	90.88

"On the basis of these facts," Congressman Byrnes stated:

it is a distortion to claim that the proposal reverses the ability-to-pay principle or gives a tax advantage to investment over earned income. The truth is that the proposal merely partially alleviates or corrects an existing discrimination reflected in higher tax burdens on income from one particular form of investment, the one which involves the greatest risk and makes the most vital contribution to economic expansion and progress, namely, equity capital.

Interest, rents, royalties, and other forms of investment income do not bear such double taxation. These other forms of investment income are deductible by the payor, corporate or otherwise. Moreover, these other forms of investment not subject to the double tax generally involve substantially less risk than equity capital commitments.

The President's Broadcast

The current in favor of increasing personal income tax exemptions, and junking measures calculated to strengthen incentives for investment, ran so strong while the House was debating the Tax Revision bill that President Eisenhower on March 15 addressed the nation by radio and television, supporting the tax bill as the "cornerstone" of his program. It was fortunate that he did, for the discussions were fast losing touch with realities.

Focusing on the long view of national welfare, he set out as the paramount objective "maximum protection of freedom and a strong and growing economy— an economy free from both inflation and depression". He pointed out that the government spending cuts being made this year are being passed back to the people, reviewed the widespread benefits from tax changes, including the support they give to employment and payrolls, and warned that "large additional savings in the cost of government at this moment means seriously weakening our national defense".

The proposed $1,000 personal exemption, the President stated, "would excuse one taxpayer in every three from all federal income taxes":

When the time comes to cut income taxes still more, let's cut them. But I do not believe that the way to do it is to excuse millions of taxpayers from paying any income tax at all.

This is an election year, the President recalled:

Some think it is good politics to promise more and more government spending, and at the same time, more and more tax cuts for all. We know, from bitter experience, what such a policy would finally lead to. It would make our dollars buy less. It would raise the price of rent, of clothing, and of groceries. It would pass on still larger debts to our children.

The President decried the "professionally faint-hearted" who argue that we are on the very brink of disaster and showed confidence that the tax revisions affecting business incentives would encourage the growth and expansion of industry, the creation of jobs, and the starting of new and small businesses.

On the relief from existing double taxation of dividend incomes, he asserted:

This will be important to all of us, whether our savings are large or small. It will encourage Americans to invest in their country's future. And let us remember this most important fact: the average investment needed to buy the tools and the facilities to give one of our workmen a job runs about $8,000 to $10,000. The more we can encourage savings and investments, the more prosperous will be 160,000,000 American citizens.

Just as we need more spending by consumers, so we need buyers for items produced by heavy industry— for lathes and looms and giant generators. The making of these things gives jobs to millions of our people. This carefully balanced tax program will encourage this kind of production. It will make new jobs, larger payrolls and improved products. It will give us lower price tags on many of the things we want and need.

A Policy That Failed

The evening after the President's broadcast, three leaders of the opposition party, Congress-

men Sam Rayburn of Texas and Jere Cooper of Tennessee, and Senator Walter F. George of Georgia, attacked the Administration plan and proposed raising the personal exemption and cutting out the dividend relief provision. Senator George advanced the case for increased exemptions on the main ground that "there are disturbing signs" in the economic picture, and "the time to meet the threat of a downswing in the economy is before it gets under way." A raise in the exemption, he stated, "will add to the consumer purchasing power of the people and will result in increased production."

Apart from the substitution of tax reduction for increased government spending, this formula for handling business slump bears an unwholesome resemblance to the policies with which Democratic Administrations twenty years ago unsuccessfully combatted the longest, severest and most costly depression in the nation's history. As Senator Flanders stated, "We had nearly seven years of experience with endeavoring to solve the problem of unemployment by consumer expenditures alone, from 1933 to 1940. The volume of unemployment was not decreased thereby." He suggested using "reasonable tax means" to support capital goods as well as consumer goods industries, as the President's balanced program attempts to do.

Congressmen Rayburn and Cooper, sharing the microphone with Senator George in their broadcast of March 16, concentrated their fire on the proposed relief from double taxation of dividend income. Mr. Cooper stated for example:

> The facts are that 92 per cent of all American families own no stock whatever. Eighty per cent of all taxpayers have incomes less than $5,000, and they get less than 11 per cent of all dividend income . . . Eight-tenths of 1 per cent of all taxpayers have incomes over $25,000 – yet they get 55 per cent of all dividend income.

The 6,500,000

The sources of Mr. Cooper's "facts" are not stated. An estimate prepared by the Brookings Institution two years ago put the number of shareholders in the United States at 6,500,000, 4.2 per cent of the population, and the number of families with one or more shareholders at 4,750,000, 9.5 per cent of the total families. This shows not only the spread of ownership of industry but also the potential for increase. One hope in the proposed relief from double taxation is to increase the breadth of ownership, the availability of equity capital, and the numbers of people who can push beyond the $5,000 level.

Mr. Cooper's statement that taxpayers with incomes under $5,000 receive less than 11 per cent of all dividend income evidently is drawn from personal income tax statistics which are incomplete for people of smaller incomes. The corporation income tax statistics indicate that total dividend payments by U.S. corporations in 1950 (excluding inter-corporate dividends) totaled $9.1 billion of which $3.2 billion was reported on individual returns with incomes above $25,000 and $2.0 billion on returns with incomes between $5,000 and $25,000. This left $3.9 billion – 43 per cent of the total dividends – of which taxpayers with incomes below $5,000 presumably received the lion's share. Dividend income of schools, churches, pension and other trust funds, etc., would also fall into this figure.

The Annual Report of the U.S. Steel Corporation, released March 16 in the heat of the controversy, gave a different picture from the one Mr. Cooper painted. A questionnaire sent to the 280,000 shareholders, answered by 140,000 of them, indicated that 53 per cent of the company's shareholders had less income than the average employee in the mills. Also the smaller shareholders were more dependent on Steel's dividends for a living than were the larger shareholders.

The 303,000

Against the total of $9.1 dividend payments in 1950, $3.2 billion shows up on the 303,000 personal income tax returns with incomes above $25,000. This is 35 per cent of total dividend payments, not 55 per cent given by Mr. Cooper. Incidentally, the 303,000 paid an average tax of $17,975 per return or an aggregate of $5½ billion federal income taxes.

It is doubtful if the dividend provision was designed specifically to aid people that are in the $25,000 bracket this year or that may be fortunate enough to be there in some future year. The deeper purpose is to stimulate, in every income range, the desire to get ahead and to save and provide the equity capital that is the life blood of our economic society; to give a dynamic lift to the powers for building and producing that Americans can demonstrate when government offers stable conditions and a square deal. It is not a socialist egalitarian program, though, paradoxically, it has the most to offer everyone. We won't get anywhere fomenting class war and disregarding the springs of our economic progress.

The American economy has been driven these past thirteen years under the abnormal stimuli of inflation, war orders, deferred demands, and special depreciation allowances. What better substitute than the propellant that moved the

nation to world preeminence, the dream of the individual to get ahead by successful venturing?

Public vs. Private Power at Niagara

The public versus private power controversy, which has engendered so many bitter words over the past twenty years, has flared anew in hearings being conducted by the U.S. Senate Committee on Public Works on the question of who shall develop the hydroelectric power potential of the Niagara River. Here, though the Committee is considering four separate bills dealing with Niagara, the major issue is whether the project shall be carried out by the State of New York or by private utility companies ready and eager to undertake it.

In this controversy there is being fought over again all the old issues that have divided proponents of public and private power from the beginning. Again there crops up the much-debated question whether publicly-produced power is "cheaper" than privately-produced power. Again there are the familiar charges that private development of water power means a direct "give-away" to private interests, "robbing the people of their heritage", and the like.

Two considerations, however, make this particular controversy of outstanding significance, not only to the people of New York State but to the country as a whole.

First, the Niagara River has the greatest potential for further power development left in the United States; and its development would serve an important already industrialized area.

Second, the Niagara River development poses the most clear-cut issue yet presented to the American people whether they want private or government operated electric facilities.

The Niagara outcome will be precedent-setting because there are no side issues to becloud the basic principle at stake. Heretofore, government entry into the electric power field has been incidental to flood control, navigation, irrigation, and reclamation; electric power was — or so it was claimed — merely "surplus" or a by-product. The Niagara River development, on the other hand, is an electric power project pure and simple; there is no flood control, navigation, or reclamation involved. What the Congress decides in this case will, therefore, go far to setting the pattern for future hydroelectric power development throughout the nation.

A Brief Background

In considering the question of power development at Niagara, two points may be stressed at the outset.

One is that the Niagara project is entirely separate and distinct from the St. Lawrence Seaway and Power project, with which it is sometimes confused. The latter is a huge undertaking some 250 miles away, involving not only power but also construction of a channel adequate to accommodate ocean-going ships. It is a truly international project, requiring joint activities of the United States and Canada. Private enterprise is not seeking to take on that job.

By contrast, the Niagara project is not an international undertaking, insofar as requiring joint construction with Canada of the works necessary to produce the power desired. All of the American power facilities will be entirely within the United States. Moreover, the project, as stated earlier, is concerned only with power, and neither navigation, irrigation, nor reclamation enters into it.

The second point is that the construction of new private generating capacity at Niagara will not mean blazing any new trail. The Niagara Mohawk Power Corporation, one of the leading private petitioners in the present controversy, already has five power plants located at Niagara and, in fact, has been generating power on the site for more than fifty years. All that the private utility companies are seeking is the right to instal the additional works that will be necessary to utilize the additional water authorized by the Treaty of 1950 concluded between the United States and Canada.

Proposed Legislation

Four different bills for developing Niagara are before the Congress, where the issue will be decided under the U.S.-Canadian treaty.

One, the Capehart-Martin-Miller-Dondero bill, proposes that private enterprise develop the power and distribute it at rates regulated by the New York Public Service Commission on a cost-of-service basis. This method would produce substantial tax revenues for Federal, State and local governments. Following extensive public hearings in the House of Representatives last year, this bill was passed by that body in July by the substantial margin of 262 to 120.

A second bill, proposed by Senator Ives and Representative Becker, proposes construction by the New York State Power Authority. Funds would be provided by tax-free revenue bonds and the power sold to all consumers through any and all distributors, public and private, but with preferential provisions for residential and rural consumers.

A third bill, by Senator Lehman and Representative Roosevelt, originally proposed that the Federal Government construct the project with tax funds. Since this had little support, the new Lehman-Roosevelt bill would have the New York State Power Authority construct the project but give preference in the sale of power to public bodies and cooperatives. The effect of the "preference clause" in this bill would be to promote government sale as well as generation of electricity.

A fourth bill, by Senator Case of South Dakota, would leave the decision as to construction up to the Federal Power Commission. In effect, this would mean turning the job over to the State, inasmuch as the Federal Power Act requires the Commission to give preference to the State in such matters.

The Case for Public Power

There are no significant differences under these various bills in the engineering aspects of the project, only in who shall undertake it. All plans provide for remedial works necessary to protect and enhance the scenic beauty of the Falls. The case for public power, therefore, reduces itself to a method of management and financing.

Briefly stated, the arguments of the public power backers fall into three main categories:

1. That, according to law and long-established public policy, water power sites are the property of the people of the State, and the State should develop them.

2. That public power is "cheaper". It would, it is argued, "save" the people $31,000,000 a year on their electric bills to have the State develop Niagara.

3. That the private enterprise bill would deliver the electric power of the people of the State into the hands of the private utilities for their "exploitation".

The Argument as to Law and Public Policy Examined

This argument was presented in testimony of Governor Dewey before the Senate Committee on Public Works last summer, as follows:

> . . . by law, by the resolution and action of both parties, and all Governors for thirty years, the waterpower with which you are dealing is the property of the people of the State of New York — inalienable . . . The Ives-Becker bill is simply a reaffirmation of the traditional position of the country for the last thirty-three years. It allows the Power Authority to develop the Niagara power in the same way as under its license to develop the power in the St. Lawrence.

Mr. Dewey in his testimony referred to the Power Authority Act passed by the State Legislature in 1931 and concerned originally only with improvement of the St. Lawrence, but later amended to include the Niagara River. He cited numerous instances of endorsement of public development of water power in platforms of both major political parties over the years, and invoked as champions of public power such statesmen as Theodore Roosevelt, Charles E. Hughes, and Herbert Hoover.

The first and most obvious comment on such evidence is a reminder of the existence, already mentioned, of private power development at Niagara for over half a century. As for the Act of 1931, cited by the Governor, this applied originally, as stated above, to the St. Lawrence only. Not until 1951 was it broadened to include Niagara by an amendment rushed through, without public hearing, in the closing days of the Legislature.

The few quotations from Charles E. Hughes and Theodore Roosevelt can hardly be taken as conclusive of their views on power development at Niagara, since private companies were already operating there and both men while in public office signed bills providing for private development of water power resources. Mention of Herbert Hoover was on the strength of his sponsorship of the Hoover Dam on the Colorado River. This is a multiple purpose hydroelectric operation, combining power, flood control, irrigation, and provision of water supply for coastal cities, and not at all like the single-purpose power development at Niagara.

All this talk, however, of who did and said what in the past is really beside the point. Except for demonstrating that the record as to law and public policy is by no means so one-sided as the proponents of public power would have us believe, it serves little practical purpose today. It must be remembered that in times past privately-owned utility companies were not as closely regulated as they are today. Nor were the people as heavily burdened with public debt and taxes. The mere fact that there have been advocates of a form of socialism in the past does not establish it as good principle today. What we need to do now is to weigh carefully the real facts of the Niagara controversy in the light of present day conditions, bearing in mind the implications of what we decide to the kind of economic society in which we wish to live.

Question of "Cheapness"

Point No. 2 in the State ownership case outlined above must surely suggest its own answer. Seldom has the myth of low-cost public power been revealed more clearly than in the following further quotation from Governor Dewey's testimony in the Senate hearings last year:

. . . our consumers will be charged at least \$31,000,000 more each year. That is made up as follows: There are different estimates on the Federal taxes involved, but about \$10,000,000 would be paid by the project. These taxes would be saved to our consumers by the Power Authority program. There would be about \$11,000,000 more of State and local taxes saved . . . and there would be about \$10,000,000 a year saved on the financing. This is the difference between the 3½ per cent cost of money to the Power Authority and the 6 per cent return that would be allowed the company. So Power Authority development will save the consumer approximately \$31,-000,000 a year.

It must be obvious that what is proposed here is no real saving in taxes, but merely a shifting of part of the cost of electricity from the consumer to the taxpayer — who may even be the same person. Electric bills may be smaller, but since there is no reason to suppose that government possesses engineering, technological, or managerial advantages superior to those of private enterprise, tax bills must rise by an amount sufficient to compensate for tax exemption on the project and on the securities. In other words, the alleged tax saving proves to be, on analysis, nothing more nor less than a subsidy granted to the users of tax-free power at the expense of the general taxpayers, Federal, State, and local. Just why the consumers of electric current should be especially favored in this way is difficult to see.

On the basis of "tax savings" arrived at in this fashion, and elimination of any return upon investment, government has a tremendous advantage in competing with tax-paying private enterprise, especially in these days of sky-high tax rates, Federal, State, and local. Following the line of reasoning exemplified in the quotation above, there is no limit to the extent to which government might invade the field of private business.

The "Exploitation" Bogey

The third point — the "exploitation" argument — is a hoary old bogey conjured up to influence the unthinking, the ignorant, and the prejudiced. To hear some of the charges bandied about of "exploitation", "give-away", and "robbery", etc., one might suppose that the private utility companies were free to do as they please, reaching out their tentacles to fasten upon property of the people — after the manner depicted in old-time cartoons — milking the public with exorbitant rates, and piling up huge profits. One would hardly get the impression that the companies are, in fact, subject to the strictest kind of regulation in almost everything they do.

As the New York State Chamber of Commerce pointed out in resolutions adopted in January endorsing the private enterprise bill for Niagara, the law does not *guarantee* the utility companies a profit; it only *limits* their permitted profits. For those persons who need a reminder of the tightness of the public supervision and regulation of these companies, the following quotation from the 1948 annual report of the Southern California Edison Company to its shareholders should be of interest:

Your Company, under public regulation, is required to provide uniform and nondiscriminatory public service to all who comply with public rules and regulations. Your Company is not "private" in the sense of being free from public taxation, regulation and control as are similar properties which are financed directly from the public purse. About the only feature which is "private" about your business is that it is financed by the savings of private citizens and not from the public treasury. From that point on, the entire process of investing the funds, of generating, transmitting, and distributing the electricity to the ultimate consumer, the rates and conditions of service, are prescribed by government agencies. Although maximum earnings of your Company are fixed by regulation, there is no guarantee of minimum earnings.

We hear a lot said about water power being a natural resource "belonging to the people"; therefore, that only government should develop it. But so too are coal, oil, timber, metals, sulphur, salt, and so on, natural resources; yet this has no relevancy as an argument against private enterprise. The only relevant consideration is not *who* develops these resources, but *how* they are developed — that is, whether they are developed in a way so that the maximum benefits flow to all the people.

A Matter of Principle

Americans have traditionally and as a matter of principle developed their natural resources under private enterprise, with the initiative and dynamic qualities that go with private ownership and management. There are, of course, certain exceptional activities of broad public benefit, regarded by common consent as not suitable for private enterprise, in which government may appropriately engage. Examples of these may be found in some of our great river basin developments where expenditures for flood control, irrigation, and reclamation, combined with power, are not expected to be productive of sufficient revenue to justify private investment.

But the line is not a hard one to draw. Where responsible private enterprise is ready and willing to engage in an undertaking with private funds, only the most compelling motives can justify departure from the private enterprise principle upon which this country has been founded. This is the real issue at Niagara.